RBI’s Shaktikanta Das on financial sector reform, sticking to inflation targets and the e-rupee

The Reserve Bank of India governor speaks about developing credible self-insurance and sizeable FX reserves, inter-dependence with government, non-bank and bank regulatory reforms, demonetisation, rupee internationalisation and daily UPI payments hitting 300 million transactions

Shaktikanta Das

Juno Snowdon

By Christopher Jeffery and Daniel Hinge
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When you first became governor, what were some of your key strategic priorities?

When I joined in December 2018, the Reserve Bank of India [RBI] was confronted with two major challenges. One, GDP growth was already showing signs of moderation. And two, the financial markets had almost been frozen due to the collapse of a large non-bank financial lender. There was no liquidity flow. But more than that, a lack of confidence was slowly building up in the system. There were worries being expressed all around that other non-bank lenders might fail. There was a crisis of confidence in the financial markets.

Inflation was well below our 4% target, so we started a rate-cut cycle in February 2019. We did a 25-basis-point rate cut, and we followed it up during that year with a few more rate cuts. That was to address the problem of the slowing economy. Even the banking sector was having difficulty carrying on with lending and other activities. So, we took upon ourselves to slowly inject liquidity into the system. It had to be done in a very smooth manner, without showing any sign of panic or ringing any alarm bells. Central bank action should not be seen as panicky. We injected liquidity using an innovative method, a buy/sell swap of foreign currency. We bought about $10 billion in two instalments. This buy/sell was for a period of three years, which means we give back the dollars in three years and take back rupees. Therefore, liquidity was injected for a finite period.

Supervision of the banking sector was made robust. I was personally monitoring – and our supervision teams were monitoring – the liquidity positions of the top 100 non-banking financial companies [NBFCs], about 90% of the total size of the NBFC sector. Almost every week, I was taking a briefing about the liquidity situation. Our supervision people were constantly engaged with those NBFCs, nudging them, to improve collections and raise liquidity. In one of the press conferences, I stuck my neck out and said we will see none of the large NBFCs collapse. I told our supervisors: "Now I have stuck my neck out, you have to see that what I have said is fulfilled!" And to the credit of our team, there was intense supervision and follow-up. By the end of the year, things were all normal. The market had developed confidence in itself – and in the central bank being able to deliver what it promised.

> **Shaktikanta Das** is governor of the Reserve Bank of India, a role he has held since December 2018. From 2017–18, Das was a member of the Fifteenth Finance Commission and India's sherpa to the G20. Previously, over a career of more than 40 years, he served as an Indian Administrative Service officer for the Indian and Tamil Nadu governments, including roles as economic affairs secretary, revenue secretary and fertilisers secretary. He was also India's alternate governor in the World Bank, Asian Development Bank, New Development Bank and Asian Infrastructure Investment Bank. Das holds a postgraduate degree from St Stephen's College, Delhi University.

Then the coronavirus struck. Can you say a little about the RBI's response to Covid-19?

Suddenly you found that people could not come to the offices. We wanted to ensure our market operations kept functioning. We run the government borrowing programme – and both the primary and secondary market platforms are owned by the central bank. Then there are the payment systems and the RTGSs [real-time gross settlement systems that have operated 24x7x365 since December 14, 2020], which, again, are operated by the RBI.

And there are various other money market platforms.

Naturally, those operations had to go on uninterrupted. So, we set up a quarantine facility in just four or five days. We converted one of our data centres in the outskirts of Mumbai. It was completely sanitised. We had a nearby hotel and buses to drive people to work. Two hundred of our staff and service providers were quarantined there. So, the markets continued to function – the government securities market, the forex market, etc. All the money market operations continued without any interruption at all. We ran this for almost one-and-a-half years. We did rotate the staff, but 200 people were there.

The RBI seems to have had a turbulent relationship sometimes with the government. How would you rate that relationship now? Is it possible to maintain a good working relationship while safeguarding the central bank's independence and avoiding fiscal dominance?

The relationship between the central bank and government, in any scenario, in any country is one of interdependence. Therefore, the relationship has to be based on a constant dialogue. To bring about improvements in the financial sector, we need legislative changes. In India, for example, the NBFC sector needed many legal changes. We did not have certain powers, which acted as an impediment in the RBI's ability to regulate and supervise the sector, and resolve failed companies. We engaged with the government, and we got those amendments. We have a large body of co-operative banks. There was dual regulation – part with the government, part with the central bank. It can't be that way. We again had a dialogue with the government, and we got the required amendments. Now, changes to the law can only be undertaken by the government. So, you need to build up that kind of a working relationship with the government because we need their support. In the same way, the government also needs the central bank's support in many situations – for instance, if there is a liquidity problem.

A dialogue does not mean a compromise of autonomy at all. In the end, you decide what you want to do. But it is useful to share each other's concerns. In any case, both have the same objective, both are working for the economy. Take the inflation situation. While we started tightening liquidity, increasing our policy rate, at the same time, there were many supply-side measures that were required to be undertaken by the government. So, we were in constant dialogue with the government. There will be differences. The way the central bank and government look at things does vary. But whatever differences of opinion there are, it is better to resolve them through internal discussions.

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You mentioned the acute issues in the non-bank sector, but there have also been long-running problems in major banks, particularly public-sector banks. What is your view of the overall health of the Indian banking sector now?

Over the last four years, we have carried out a series of regulatory reforms in the banking sector, public and private. We have issued governance guidelines about the functioning of the board, audit committee, risk management committee, the internal audit system and appointment of certain senior officials with the required level of independence. The focus has been on strengthening the governance of the banking sector. In the banking sector, we have issued the large exposures framework – how much exposure a bank can take to a single company and a group.

For public-sector banks, the laws specify certain requirements. Other than that, as far as the RBI is concerned, our regulatory and supervisory approach is ownership-neutral. For non-bank lenders, we have introduced a scale-based regulation. Non-banks are sorted into four categories, based on their size, activities, interconnectedness and complexity. Some of these non-bank lenders are as big as a mid-sized bank, some are as small as an entity confined to a particular city or locality. So, it is not necessary to have the same regulation for each type of entity. Based on that, the supervisory focus can be really on the big ones, which can cause systemic problems.

Supervision is an area we have really strengthened. As a result, the Indian banking sector today is very stable and healthy. All the parameters in terms of capital adequacy, liquidity, percentage of stressed assets – from any parameter you measure, the banking sector is stable and healthy. And we do stress tests as well, and we did that again after the failure of banks in the US and Credit Suisse in Europe. In even the most stressful situations, banks will be able to meet the minimum capital requirement.

What was the underlying worst-case scenario for the stress tests? Did it include a major change in interest rates?

The tests included various adverse macroeconomic scenarios. The stress tests also cover liquidity and interest rate risk in various stress situations. We have also been encouraging banks themselves to do their own stress tests and share the results with us.

There were very high run rates we saw in these US banks and Credit Suisse – the information age has facilitated fast

communication, and, with an app, you can take your money out immediately. Have you looked at that at all?

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What happened in the recent experience in the US, due to various factors, there was a sudden loss of confidence. There was a panic among investors that one bank was likely to fail, and one panic triggered another. You are right, in this age of social media, information spreads so fast, and withdrawals are made online. A bank that suffers withdrawals of $40 billion in a matter of hours is obviously going to face a big crisis. The key learning is that building confidence and trust in the market and among depositors is critical. That is again linked to governance of the bank.

Today, it has become necessary for banks that rely on depositors' money to monitor social media and respond to it. In the RBI, we have a mechanism of monitoring social media. Sometimes when we see something, we alert the bank concerned almost immediately: "Such and such a story is going around, so you may better deal with it."

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Some say the clean-up of non-performing assets has slowed in recent years. How do you respond to that?

Some large non-performing assets have already been resolved. A few others are still before the resolution authorities. Almost all the bad assets have been provided for in the accounts of the banks. The insolvency and bankruptcy law was introduced in 2016, so naturally the jurisprudence around that law had to be developed. Initially, many aspects of that law were challenged, going right up to the Supreme Court. The law got well settled. After that, there were quick resolutions of some of the large assets. As and when these loans got resolved, banks made recoveries and rolled back the provisions which they had made. That added to the improvement in their balance sheet.

Today, we don’t have that problem, but going forward, the process part could perhaps require some changes. There is a separate regulator for this, and we have also given our suggestions to the government.

You mentioned the importance of governance. Are you satisfied with the level of governance, at major Indian banks in particular?

By and large, yes. The governance standards, the professionalism, the ‘hawk’s eye’ with which banks now look at issues of risk management, and other vulnerable areas… today, I can see they are more agile and alert than they were a few years ago.

Incidentally, we had a conference for directors of banks recently, and our supervisors have constantly engaged with the bank management as well. I have an interaction about once in six months with the CEOs of banks – public and private. In such meetings, also, we have been sensitising bank CEOs about the importance of all these issues.

There is frequent talk about the privatisation of public-sector banks. Do you see that as being feasible? And do you think it would help?

The government has announced its intention to privatise certain government owned banks. One bank is already under the process.

The RBI only comes into the picture when the new investor has to get regulatory clearance. Other than that, the process is handled by the government.

Turning to monetary policy, you mentioned early on in your time as governor the need to cut rates to boost growth. More recently, inflation has been above-target – some people said the RBI seemed to have an informal target of 6%. What is your viewpoint on that?

Our target is 4%, with a tolerance band of 2 percentage points, plus or minus – when we are outside the band for three quarters, that is treated as a failure. So, there is flexibility in our framework. When Covid hit us, very consciously, the monetary policy committee decided to operate within the band, but tolerate a higher level of inflation. The economy needed support in the extremely stressful times of Covid.

In February 2022, our assessment was that the average inflation for the financial year 2022–23 (starting in April 2022) would be 4.5%. But then the war started in Ukraine, and the entire complexion changed. Inflation spiked, and commodity prices went up very steeply. Core inflation – non-food, non-oil inflation – also rose. Once the tightening cycle began in April 2022, the monetary policy committee changed the order of priorities, and said inflation now takes priority above growth. The economy had proved to be resilient, and withstood the onslaught of the Covid crisis. In the latest policy statement, I clearly said: "Being within the tolerance band is not enough. Our goal is to achieve the target of 4%, going forward."

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More generally, do you think that, given some of the geostrategic and demographic changes we have seen, inflation targets should be higher around the world?

In 2021, I think almost every major central bank carried out a review of their frameworks, and almost all have concluded that the existing targets need to be persisted with. The RBI also reviewed its monetary policy framework. We recommended that 4% was the desirable target, because our analysis shows 4% is the level at which there will be optimum growth. The government notified the central bank about its target for five years (2021-26). Therefore, I feel existing targets are quite robust, they are built over a period of time. And because of the experience of the last two or three years, with many black swan events, one should not in a hurry shift the goalposts.

The RBI's foreign exchange reserves were above $590 billion in June. What is the right size for India – a big economy, a growing economy?

The decision to build up solid reserves was a conscious decision. About four years ago, in 2019, I gave a speech on the sidelines of the

IMF Spring Meetings: I said central banks, particularly of emerging-market economies, need to have strong reserves. In the 'taper-tantrum' period [mid-2013], suddenly, India had an external sector crisis, and the RBI had to attract foreign inflows by offering some incentives.

We did not want to have a repeat of that situation. For that, we needed to build reserves, which have to be strong. So, as a conscious policy, when the inflows were good, we started to build our reserves, and reached a peak of about $642 billion. That really helped us – investors and the business community get a lot of confidence that the country will be able to honour all of its external obligations.

Last year, after the war in Ukraine started, there were outflows. We were able to intervene in the market at the right time. Therefore, over the last year, the rupee has been one of the least volatile currencies among our peer economies.

Have you changed your philosophy about how to invest the reserves? For example, by once more engaging external asset managers?

Like any central bank, we have three priorities. The first is safety, the second liquidity, and the third is return.

We have engaged some external asset managers, but that is only to gain experience, it is not a change in strategy. The RBI continues to manage its own reserves. It is an experiment we are doing to learn how they do it. It is a very small amount we are offering to them. We want to learn, to interact with the external asset managers, and it should help to build our own internal capacity.

You are also stepping up efforts at rupee internationalisation. Can you talk through some of the steps there? What are the potential benefits?

Internationalisation is a process – we don't look upon it as an event or a target that has to be reached by a particular date. It is mainly to facilitate a smooth experience for importers and exporters.

In July 2022, we issued a circular permitting rupee settlement of international trade. After that, quite a few banks from other countries have opened rupee vostro accounts. That is already in process – banks from 18 countries have been given approval to open rupee vostro accounts.

In India, we have no shortage of dollars, but in some other markets, due to a shortage of dollars, they are unable to do imports. So, in a sense, it is a facility we are giving, so countries can continue to import from India and settle in rupees. It also de-risks importers and exporters from both sides, from the volatility of international currencies.

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One of your predecessors as governor spoke about spillovers from advanced-economy monetary policy to emerging and developing economies. Is the US Federal Reserve doing more to counter some of the problems? Or is it less of a problem for India these days due to you building up your reserves?

For each central bank, the priority is the domestic situation. Therefore, it is very necessary for emerging-market economies to be aware of that – this is the reality of the modern world. Take your own steps to make your systems more resilient. I have spoken about how we built up our reserves. Today, we are much more resilient to fluctuations in advanced-economy currencies.

Having said that, the monetary policy actions of large central banks, especially the US Fed, do have an impact on our exchange rate. There are several ways in which it can impact our markets. We must build our own strength and mitigate those spillovers. That is an ongoing process that involves anticipating events. So far as our monetary policy is concerned, while recognising that the actions of the US Fed does have an impact on countries like India, our policy decisions are primarily based on domestic factors.

Potentially, trade links could be helped by a wholesale central bank digital currency (CBDC) with atomic settlement in rupees. Can you give us an update on the RBI's e-rupee project? And what are the next steps for the RBI's payment systems? The Unified Payments Interface (UPI) is widely recognised as world-beating.

We are running a pilot project in both retail and wholesale CBDC. In November 2022, we launched the wholesale pilot, and, in December 2022, the retail pilot. It is a project to gather experience on how it works, what are the deficiencies, which are the ideas that need to be further fine-tuned? It is not just technology and in terms of the safety and security of the digital currency, but also in terms of processes, and various regulatory and legal changes that may be required.

For example, in India, we have certain capital controls in place. By and large, the controls have been removed, but still there are some controls on capital flows. So, therefore, the pilot is a learning process. The history of currency, if you look back centuries, has always been developing. It started with barter systems, with grains, then metal pieces … The shape of money, the form of money, has evolved over time. From paper currency, we moved to plastic cards – that has now been overtaken by the mobile phone, at least in India. You don't need to carry a banknote, a credit or debit card in India. Everything can be done through a mobile phone, thanks to

UPI. Many youngsters today don't carry a purse, don't carry a card. That is how the world is moving.

CBDC is going to be the future of money. Therefore, we are preparing ourselves for that. By the end of this month, we hope to reach about 1 million users of retail CBDC. That is for domestic payments. But cross-border payments will also become much quicker, more seamless and very cost-effective. That is another area where a lot of attention needs to be given. We are constantly in dialogue with other central banks that have introduced or are introducing CBDCs. That is going to be the future.


Juno Snowdon

Do you have any prediction on when it will happen?

No – it is impossible! These things evolve, and sometimes things move very fast. UPI was introduced in 2016. Today, the daily number of transactions in UPI has crossed 30 crore (300 million). When it was launched, nobody imagined it would grow so rapidly. But the way technology is growing in the modern world, it could be sooner than anybody expects.

The RBI has engaged in demonetisation efforts, one of which was controversial, and there was also the recent withdrawal of the 2,000-rupee note. What have you learnt from these processes?

This year, we withdrew the 2,000-rupee notes from circulation, but they continue to be legal tender. The key difference between 2016 and now is that, in 2016, the legal tender status of the 500-rupee notes and 1,000-rupee notes was withdrawn.

The 2,000-rupee notes were introduced for a particular purpose, to replenish the value of currency being taken out as part of the 2016 withdrawal of legal tender status of the 500- and 1,000- rupee notes. The purpose has been fulfilled – that is why we are withdrawing it from circulation, and we have given four months for this. It is part of our currency management.

We have found 500-rupee notes have emerged as the main denomination in circulation. The 2,000-rupee notes are not much used in transactions. We stopped printing them in 2018 because there was no demand. The number of 2000-rupee notes in circulation had come down over time, to about 50% of their peak. So, we felt it was time to withdraw it.

Overall, the economy is growing, but is the amount of cash in circulation being reduced because there are so many electronic payments now?

There is still steady growth in currency in circulation. There are seasonal ups and downs. The number of digital transactions per day, including UPI, is about 380 million. That is growing exponentially. The pace of increase in currency in circulation has moderated.

You have been public in your criticism of crypto assets. What steps are you taking in India and at the Group of 20 level? Are you happy with progress so far?

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As you know, India holds the presidency of the G20 this year. Unlike the situation one-and-a-half years ago, today, most central banks are very concerned about cryptocurrencies, the way they are operating, their impact, the fallout and associated risks. I have been very vocal about it, and I stick to my views.

The first fundamental question I ask is: “What public good do cryptocurrencies serve?” We need a very credible answer for that. The technology on which crypto is built is different. The technology has many other applications. The technology can grow and flourish – but it does not need a cryptocurrency styling itself as an asset to enable that growth.

It is purely a speculative activity. For countries like India and other emerging economies, cryptocurrencies have serious consequences for our monetary system and our regulation of capital flows. Ultimately, it will cause financial stability challenges for emerging-market economies.

India’s growth performance has been very strong in recent years, but there are still structural problems – things like labour-force participation, informality, some governance issues. Do you think authorities are well set up to tackle the problems that are still there?

I am quite optimistic about India’s growth. At the moment, India is the fifth-largest economy in the world, and is poised to become the third-largest economy by 2027. The government has undertaken various structural reforms. So far as the central bank is concerned, our role is to provide a financial ecosystem that facilitates India’s growth story. Growth, together with inclusiveness, is the priority of the government and our priority. We spend considerable attention on issues of financial inclusion and consumer education. The future has to be based on growth with inclusion. In our payment systems, also, inclusion and access is very important. If you travel to India today, you will find that even small roadside tea vendors and vegetable shops have access to UPI.
